



North America Power & Utilities

Straight from the Tap: US Water Utility Monthly

In this month's Straight from the Tap, we preview 1Q21 earnings for AWK and WTRG and discuss recent regulatory updates and potential implications of forthcoming water infrastructure legislative efforts.

AWK 1Q21 preview summary - 1Q21E EPS: \$0.73. We expect a very straightforward 1Q21E earnings release for AWK as the company enters a relative quiet period now that PA, NJ, and MO rate cases are in the rear view mirror. We expect management commentary to highlight the strong regulated M&A execution YTD following the York deal (*AWK: Regulated M&A Train Rolls Through York, PA*, published 4/7/21), in line with upsized guidance on the 4Q20 call in February. We also anticipate commentary on potential legislative packages at the federal and state level. AWK's New York divestiture is the only remaining overhang, albeit unlikely to prove material in our view, as Governor Cuomo's efforts to push for municipalization as part of a larger budget bill seemingly stalled in the legislature. We reiterate our Equal Weight rating for AWK given our view that the sizable premium to the regulated utility group captures growth upside from regulated M&A amidst a broader ESG prioritization in both politics and financial markets.

WTRG 1Q21 preview summary - 1Q21E EPS: \$0.66. We expect a cleaner 1Q21 EPS print as YoY comps now reflect the Peoples deal, though regulatory and legal updates could prove to be more nuanced. We are interested to hear management's perspective on the recent Delcora ALJ stay order, legal case progress, and how the process interacts with financing planning. We expect additional color on Peoples Gas rate case timing following WTRG's commitment to file a base rate case by year-end 2023. The company made the commitment as part of its repairs tax settlement to placate intervenor concerns about potential overearning from ongoing tax benefits above forecast. We expect management to provide a summary of the settlement terms and how the flow-through regulatory accounting interacts with earnings given the agreement compensates customers for 100% of catch-up benefits via a fixed annual surcredit for five years, while WTRG will not monetize the tax benefits as long as it retains an NOL position. We reiterate our Equal Weight rating on WTRG and believe the discount to AWK reflects a lower growth outlook and AWK's pure-play water scarcity. We do not expect near-term Delcora uncertainty to have a material impact longer term, but acknowledge risk that a protracted process serves as an overhang. With repairs tax nearly complete, we think a simplified profile with upside potential from regulated M&A should resonate with investors after Delcora is resolved.

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 10.

INDUSTRY UPDATE

North America Power & Utilities

POSITIVE

Unchanged

For a full list of our ratings, price target and earnings changes in this report, please see table on page 2.

North America Power & Utilities

Eric Beaumont, CFA

+1 212 526 8334

eric.beaumont@barclays.com

BCI, US

Evan Friedman

+1 212 526 4824

Evan.Friedman@barclays.com

BCI, US

Ian Rapp

+1 212 526 3492

Ian.Rapp@barclays.com

BCI, US

Summary of our Ratings, Price Targets and Earnings Changes in this Report (all changes are shown in bold)

Company	Rating		Price	Price Target			EPS FY1 (E)			EPS FY2 (E)		
	Old	New	21-Apr-21	Old	New	%Chg	Old	New	%Chg	Old	New	%Chg
North America Power & Utilities	Pos	Pos										

Source: Barclays Research. Share prices and target prices are shown in the primary listing currency and EPS estimates are shown in the reporting currency.

FY1(E): Current fiscal year estimates by Barclays Research. FY2(E): Next fiscal year estimates by Barclays Research.

Stock Rating: OW: Overweight; EW: Equal Weight; UW: Underweight; RS: Rating Suspended

Industry View: Pos: Positive; Neu: Neutral; Neg: Negative

AWK 1Q21 Earnings Expectations

1Q21E EPS Bridge

Our \$0.73 1Q21E EPS estimate contemplates various rate increases from infrastructure surcharges, limited issue trackers, and partial realization of rate relief following GRC decisions at AWK's largest operating companies in PA and NJ. Surcharges and general rate relief is expected to provide more than enough offset to incremental financing and operational costs throughout FY21, though rate relief pacing shifts much of the cash benefit post 1Q21. We note that AWK's guidance basis EPS now includes DD&A benefits associated with the NY sale, the impact on Q1 is de minimis, as only \$0.01 is added back to reported 1Q20 adjusted EPS.

FIGURE 1

AWK 1Q21E YoY Drivers

AWK EPS Walk	
1Q20A	\$0.67
Rates and Customer Growth	\$0.05
Infrastructure	\$0.03
NY DD&A	\$0.01
MBB	\$0.01
Weather	\$0.01
Additional DD&A	-\$0.02
Interest Drag	-\$0.03
1Q21E	\$0.73

Source: Barclays Research

Expected Call Topics:

Regulated M&A Execution

We are expecting management to highlight the York wastewater deal and the general market strength for regulated M&A across AWK's national footprint (FMV laws cover 10 states and water quality accountability laws cover 3). We do not anticipate changes to the guidance provided during AWK's combined 4Q20 earnings and Investor Day in February, but expect a reiteration of confidence amidst strong early execution.

Sentiment on regulated M&A has been strong in recent months as muni budgets are strained following Covid-19 and environmental compliance costs are expected to rise as EPA enforcement rates increase under President Biden's administration. However, numerous federal policy proposals being floated to provide direct investment or bolster funding access for municipal water infrastructure could, all else equal, reduce the impetus to sell to AWK.

We believe it is too early to predict final terms of any water infrastructure package, as Republicans have not presented a counter proposal, but President Biden's proposal indicates that lead pipe replacement and water quality standards (contaminant regulations, PFAS monitoring and remediation) are going to be prioritized (see: [link](#)). While specific earmarks for rural and disadvantaged communities could help, we note that major cities and large municipal systems have historically received the bulk of federal funding versus smaller systems that AWK tends to prefer as acquisition opportunities. Regardless of likely concession and compromises, the President's proposal allocates \$45bn for lead pipe replacement (WIIN grants), \$56bn for disadvantaged and rural communities (upsized existing programs), and \$10bn to remediate PFAS in drinking water and upgrade small rural systems. \$110bn compares to the American Society of Civil Engineers estimate that \$1tn of water

infrastructure investment is needed in the US over the coming 25 years. The infrastructure package is light on wastewater systems, which we anticipate will continue to make up the bulk of regulated M&A moving forward. Thus, we see plenty of opportunities for AWK in small to medium wastewater systems (5,000-30,000 average customer systems).

NYAW Exit Headaches Persist

At Governor Cuomo's direction, on March 29, 2021, the New York Department of Public Service (DPS) presented a municipalization feasibility study that concluded a public takeover of AWK's Nassau County system is the optimal and least cost option. The primary concern from lawmakers is the outsized customer bill (a result of high local property and franchise taxes that make up 38%-60% of total bills) and an upcoming rate increase (26% increase in some rate classes) set to take effect on May 1, 2021. The DPS report found that municipalization was the optimal path because the inefficient tax collection structure creates numerous inequities and inefficiencies, including paying higher federal taxes when compared to a scenario where NYAW becomes tax exempt and those tax revenues are replaced with higher property taxes. The recommendations from the DPS were to immediately pass legislation to remove the property tax burden on NYAW and create a public authority to acquire NYAW and operate the assets as a public provider.

There was a push to include municipalization authority in the 2021-2022 budget, however efforts stalled in the Assembly on concerns about how special franchise taxes might be absorbed by Long Island utilities under the proposed process. Standalone bills to defer the rate increase and authorize a public takeover were introduced after the budget efforts collapsed, and the Senate passed a version on Tuesday (4/20/21) as negotiations are ongoing with the Assembly.

We see the outcome of the NYAW process as highly uncertain, but remain confident that the PSC will stand by the authorized rate increase if needed and do not see a scenario where AWK receives less than the Liberty offer. However, we stress that the size of the system likely means AWK will comfortably absorb any near-term financial impacts from a delay. The DPS study assumes the \$608mn sale price that Liberty agreed to, plus \$84.5mn in rate base investment in 2022, less ~\$25mn for upstate assets that would be retained and deferrals owed to customers, resulting in a net purchase price of \$669.2mn. However, the study is explicit that the math is illustrative and likely inflated (maintaining negotiating options).

CA American Water Cost of Capital

CA water utilities will file updated cost of capital proceedings by May 1, 2021, to determine authorized ROE and capital structures for test years 2022-2024. CA American Water is currently authorized a 9.2% ROE on 55.39% equity layer from a 2018 CPUC decision. It is worth noting that the ALJ proposed decision suggested an 8.23% ROE (avg US water ROE was 9.5%), which was met with significant industry backlash before commissioners decided on the higher 9.20%. It is also important to note that the WRAM decoupling mechanism was a critical element that the ALJ relied upon to justify below industry returns given lower risk. In 2020, the CPUC decided that the WRAM decoupling mechanism used by CA American Water will be replaced by a new structure to be determined during the next rate case covering test years 2024-2026. It is unclear how the cost of capital proceeding will handle the overlap and uncertainty around a replacement. For additional thoughts on the WRAM decision, see our Straight from the Tap note published 9/8/2020 ([link](#)).

WTRG 1Q21 Earnings Expectations

1Q21E EPS Bridge

Our 1Q21E EPS estimate of \$0.66 accounts for small rate relief via water infrastructure surcharges and a full year of Peoples integration. Our estimate is in line with management's projections for first quarter earnings weighting of 35%-45% of \$1.64-\$1.69 FY21E EPS

guidance (implicit 1Q21 guidance range of \$0.58-\$0.74 using the FY21 guidance midpoint). We anticipate a small amount of volumetric help YoY given customer growth (guidance 2%-3% annually) and degree day comps for gas usage in PA. We also note residential water usage trends have been strong during the covid-19 shutdowns and margin help may continue to pace favorably relative to 1Q20, providing additional flexibility to meet FY21 guidance. We also forecast small organic growth and operational efficiencies for Peoples relative to the early days of the integration in 1Q20, in line with WTRG's O&M initiatives across the business.

FIGURE 2
WTRG 1Q21E YoY Drivers

WTRG EPS Walk	
1Q20A	\$0.60
Water Rates	\$0.01
Weather and Usage	\$0.03
Peoples	\$0.02
1Q21E	\$0.66

Source: Barclays Research

Expected Call Topics:

Peoples Rate Case Timing

As part of WTRG's settlement on the catch-up component of repairs tax, Peoples committed to filing a general rate case no later than December 31, 2023 (Peoples will also likely implement the DSIC mechanism in 2023). Under the initial proposal, WTRG proposed a sharing mechanism that would have allowed Peoples Gas to stay out through 2026.

The settlement effectively provides customers 100% of \$381mn catch-up deduction tax savings benefits via a \$27.9mn annual surcredit over five years (true up in sixth year). The settlement acknowledges that Peoples is operating in an NOL position and thus cannot monetize the benefit near term, thus justifying the five-year deferral and includes various true up and reconciliation terms to ensure surcredits track actual tax benefits flowing through to Peoples.

Taking Steps Forward at Delcora but Stuck in Regulatory and Legal Maze

We discussed the ALJ PD calling for the PA PUC to reject the Delcora acquisition in the January 22 monthly, *Straight from the Tap*. The PD had three main concerns; 1) commercial customer objections to the deal, 2) the effective rate stabilization plan creation via trust refunds on bills, and 3) the ongoing legal challenge to the sale contract. The Commission took into account new settlements with numerous customers and clarifying comments from WTRG around its willingness to provide trust benefits off of customer bills to avoid being a 'de facto' rate stabilization plan and decided not to adopt the ALJ PD.

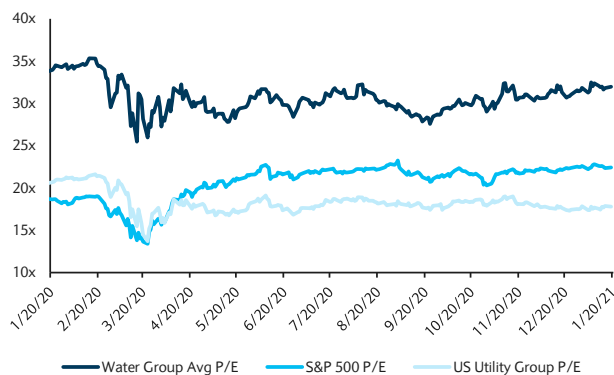
The PUC vacated the PD and remanded back to the ALJ level to reopen the docket. Importantly, as part of the reopening of the docket WTRG agreed to waive the statutory timeline requirements for a decision. The new ALJ on April 16 issued a stay order for the PA PUC proceeding until a final, un-appealable decision is reached in the county court case on whether an enforceable contract exists. Our understanding is that the appeals process could be lengthy and that WTRG will likely seek to have the ALJ order changed to allow for approval while legal appeals on contract validity play out.

We view the Delcora situation as bureaucratically complicated but the deal remains achievable if WTRG continues to execute settlements and legal decisions are upheld, however the timeline remains unclear. WTRG's \$300mn forward equity mechanism must be pulled

down by August. We still believe WTRG is likely to issue all authorized equity regardless of whether Delcora is approved in time. We also see the guidance range as intact regardless of the deal given strong M&A activity outside of Delcora. We anticipate management will highlight the strength of their deal backlog and general market activity.

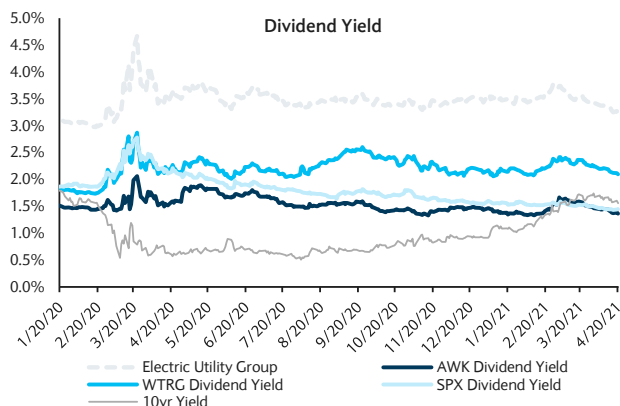
Monthly Valuation Trends

FIGURE 3
Group P/E Trends



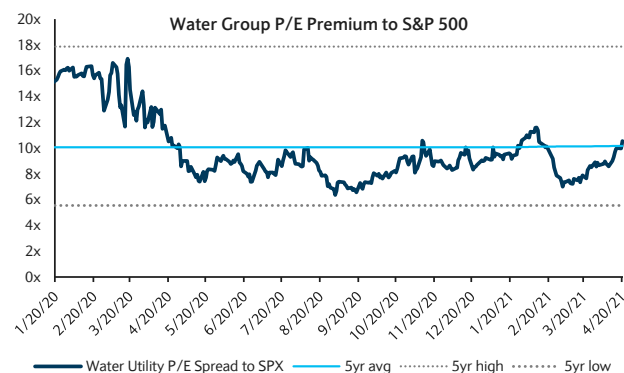
Source: Barclays Research, Bloomberg

FIGURE 4
Group Yield Trends



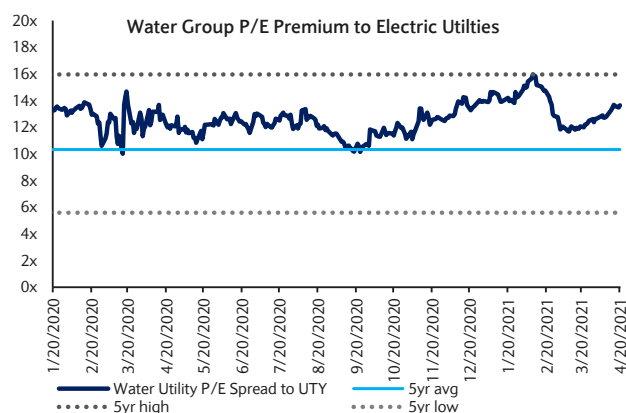
Source: Barclays Research, Bloomberg

FIGURE 5
Water Group Premium to S&P 500



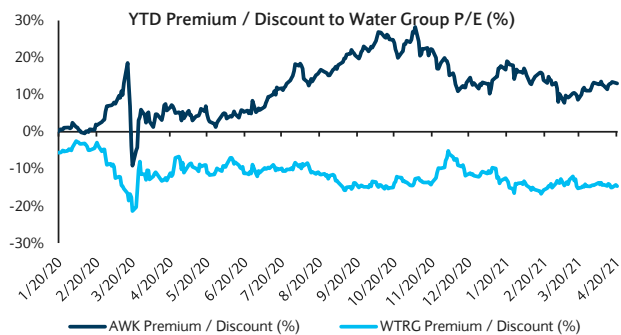
Source: Barclays Research, Bloomberg

FIGURE 6
Water Group Premium to Regulated Utility Group



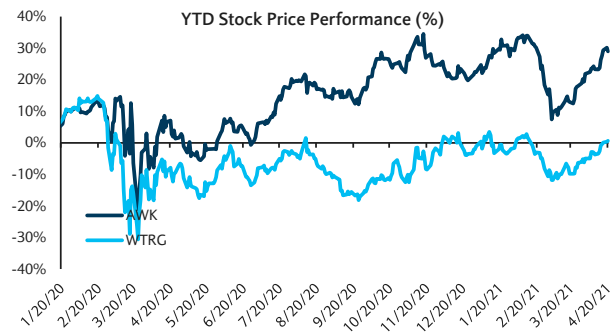
Source: Barclays Research, Bloomberg

FIGURE 7
AWK and WTRG Premium (Discount) to Water Group



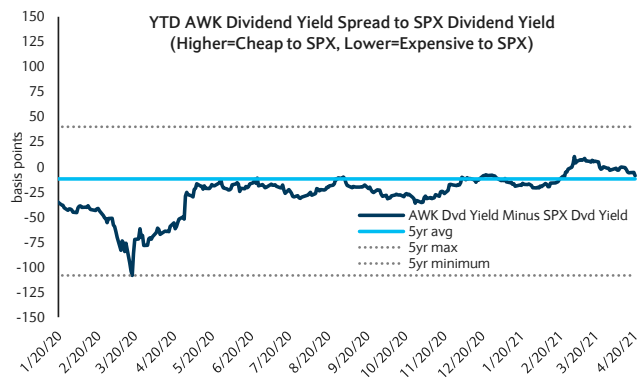
Source: Barclays Research, Bloomberg

FIGURE 8
AWK and WTRG YTD Stock Performance



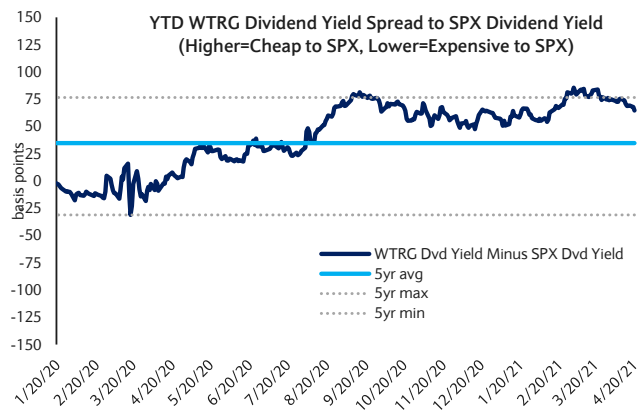
Source: Barclays Research, Bloomberg

FIGURE 9
AWK Dividend Spread



Source: Barclays Research, Bloomberg

FIGURE 10
WTRG Dividend Spread



Source: Barclays Research, Bloomberg

North America Power & Utilities					Industry View: POSITIVE
American Water Works Company, Inc. (AWK)					Stock Rating: EQUAL WEIGHT

Income statement (\$mn)	2020A	2021E	2022E	2023E	CAGR
Revenue	3,777	4,111	4,405	4,658	7.2%
EBITDA (adj)	2,155	2,338	2,507	2,681	7.6%
EBIT (adj)	1,551	1,687	1,810	1,939	7.7%
Pre-tax income (adj)	924	1,017	1,124	1,230	10.0%
Net income (adj)	709	770	851	930	9.5%
EPS (adj) (\$)	3.91	4.24	4.64	4.99	8.5%
Diluted shares (mn)	182	182	184	187	0.9%
DPS (\$)	2.15	2.34	2.55	2.78	9.0%

Margin and return data	Average				
EBITDA (adj) margin (%)	57.1	56.9	56.9	57.6	57.1
EBIT (adj) margin (%)	41.1	41.0	41.1	41.6	41.2
Pre-tax (adj) margin (%)	24.5	24.7	25.5	26.4	25.3
Net (adj) margin (%)	18.8	18.7	19.3	20.0	19.2
ROIC (%)	8.9	9.6	10.1	10.3	9.7
ROA (%)	3.1	3.1	3.4	3.5	3.3
ROE (%)	11.6	11.9	12.4	12.1	12.0

Balance sheet and cash flow (\$mn)	CAGR				
Tangible fixed assets	25,614	27,369	29,299	31,229	6.8%
Cash and equivalents	547	35	78	173	-31.9%
Total assets	24,766	25,357	26,634	27,917	4.1%
Short and long-term debt	10,940	10,671	10,291	10,265	-2.1%
Other long-term liabilities	0	0	0	0	N/A
Total liabilities	8,979	9,165	9,478	10,262	4.6%
Shareholders' equity	6,454	6,868	7,701	8,562	9.9%
Net debt/(funds)	10,393	10,636	10,214	10,092	-1.0%
Change in working capital	621	-512	43	95	-46.4%
Cash flow from operations	1,426	1,668	1,821	1,971	11.4%
Capital expenditure	-1,822	-1,555	-1,755	-1,755	N/A
Free cash flow	-920	-513	-578	-478	N/A

Valuation and leverage metrics	Average				
P/E (adj) (x)	41.2	38.0	34.7	32.3	36.5
EV/EBITDA (adj) (x)	18.6	17.1	15.8	14.7	16.5
EV/EBIT (adj) (x)	25.9	23.7	21.8	20.4	22.9
FCF yield (%)	-2.3	-1.3	-1.5	-1.2	-1.6
P/BV (x)	4.5	4.3	3.8	3.5	4.0
Dividend yield (%)	1.3	1.5	1.6	1.7	1.5
Net debt/EBITDA (adj) (x)	4.8	4.5	4.1	3.8	4.3

Selected operating metrics	Average				
Payout ratio (%)	55.0	55.3	55.1	55.8	55.3
Interest cover (x)	3.9	4.3	4.7	5.1	4.5
Regulated (%)	N/A	N/A	N/A	N/A	N/A

Price (21-Apr-2021)	USD 161.00
Price Target	USD 154.00

Why Equal Weight? AWK presents a strong growth profile with top-tier management and a solid execution track record, however valuation is stretched relative to electric and gas utilities and our valuation framework implies a 15% premium to the water group average P/E multiple, all of which is fully reflected in the current stock price

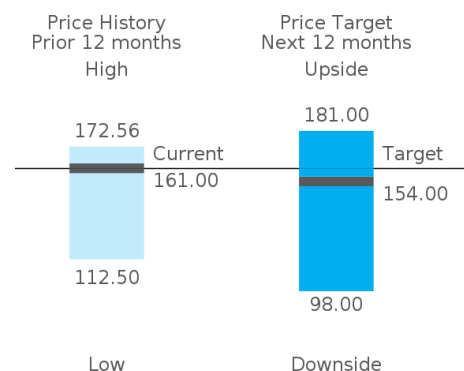
Upside case	USD 181.00
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Our upside case assumes AWK trades at a 25% premium to the group average water utility P/E multiple. We believe this scenario could materialize if ESG flows increase or general utility equity demand rises and disproportionately benefits AWK.

Downside case	USD 98.00
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Our downside case values AWK on the same 15% premium, but applies the group utility multiple in lieu of the water group multiple. This could materialize if investors perceive long-term growth opportunities and ESG profiles to be similar to electric and gas.

Upside/Downside scenarios



Source: Company data, Bloomberg, Barclays Research
Note: FY End Dec

Valuation Methodology and Risks

North America Power & Utilities

American Water Works Company, Inc. (AWK)

Valuation Methodology: We utilize a group average water P/E multiple for 2023 earnings and apply a 10% premium to AWK's consolidated 2023 EPS estimate of \$5.01 to arrive at our \$154 price target. The premium reflects strong management, constructive regulatory exposure, and top-tier growth visibility.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Risks to AWK include rate case outcomes, public system M&A deals and integration, external financing needs, and general interest rate environments.

Source: Barclays Research.

ANALYST(S) CERTIFICATION(S):

I, Eric Beaumont, CFA, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

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Primary Stocks (Ticker, Date, Price)

American Water Works Company, Inc. (AWK, 21-Apr-2021, USD 161.00), Equal Weight/Positive, CE/J

Materially Mentioned Stocks (Ticker, Date, Price)

Essential Utilities, Inc. (WTRG, 21-Apr-2021, USD 47.84), Equal Weight/Positive, A/CD/CE/D/J/K/L/M

Unless otherwise indicated, prices are sourced from Bloomberg and reflect the closing price in the relevant trading market, which may not be the last available price at the time of publication.

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Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Underweight - The stock is expected to underperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Rating Suspended - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

Industry View

Positive - industry coverage universe fundamentals/valuations are improving.

Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

Negative - industry coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "industry coverage universe":

North America Power & Utilities

Alliant Energy Corporation (LNT)	Ameren Corp. (AEE)	American Electric Power Company, Inc. (AEP)
American Water Works Company, Inc. (AWK)	Brookfield Infrastructure Partners LP (BIP)	Brookfield Infrastructure Partners LP (BIP_u.TO)
CenterPoint Energy, Inc. (CNP)	CMS Energy Corporation (CMS)	Consolidated Edison, Inc. (ED)

IMPORTANT DISCLOSURES

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Edison International (EIX)	Essential Utilities, Inc. (WTRG)	Eversource Energy (ES)
Exelon Corporation (EXC)	FirstEnergy Corp. (FE)	NextEra Energy, Inc. (NEE)
NiSource, Inc. (NI)	NorthWestern Corporation (NWE)	OGE Energy Corp. (OGE)
PG&E Corporation (PCG)	Pinnacle West Capital Corporation (PNW)	PNM Resources, Inc. (PNM)
Portland General Electric Company (POR)	Public Service Enterprise Group (PEG)	Sempra Energy (SRE)
The Southern Company (SO)	WEC Energy Group, Inc. (WEC)	Xcel Energy Inc. (XEL)

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IMPORTANT DISCLOSURES

American Water Works Company, Inc. (AWK / AWK)

Stock Rating

Industry View

USD 161.00 (21-Apr-2021)

EQUAL WEIGHT

POSITIVE

Rating and Price Target Chart - USD (as of 21-Apr-2021)

Currency=USD



Publication Date	Closing Price	Rating	Adjusted Price Target
10-Mar-2021	136.38		154.00
22-Jan-2021	160.91		184.00
18-Nov-2020	156.19		173.00
15-Jul-2020	134.06	Equal Weight	138.00

Source: Bloomberg, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

CE: Barclays Bank PLC and/or an affiliate is a market-maker in equity securities issued by American Water Works Company, Inc..

J: Barclays Bank PLC and/or an affiliate is a liquidity provider and/or trades regularly in the securities by American Water Works Company, Inc. and/or in any related derivatives.

Valuation Methodology: We utilize a group average water P/E multiple for 2023 earnings and apply a 10% premium to AWK's consolidated 2023 EPS estimate of \$5.01 to arrive at our \$154 price target. The premium reflects strong management, constructive regulatory exposure, and top-tier growth visibility.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Risks to AWK include rate case outcomes, public system M&A deals and integration, external financing needs, and general interest rate environments.

IMPORTANT DISCLOSURES

Essential Utilities, Inc. (WTRG / WTRG)

USD 47.84 (21-Apr-2021)

Stock Rating

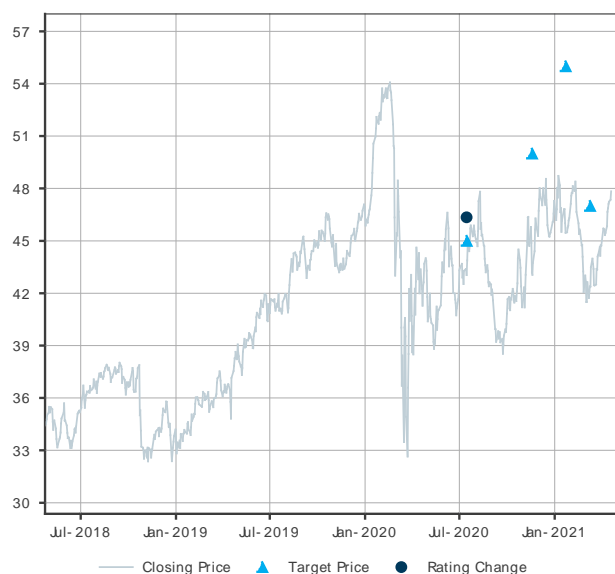
EQUAL WEIGHT

Industry View

POSITIVE

Rating and Price Target Chart - USD (as of 21-Apr-2021)

Currency=USD



Publication Date	Closing Price	Rating	Adjusted Price Target
10-Mar-2021	42.39		47.00
22-Jan-2021	45.46		55.00
18-Nov-2020	43.18		50.00
15-Jul-2020	43.04	Equal Weight	45.00

Source: Bloomberg, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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Valuation Methodology: We have a \$47 price target for WTRG. We value WTRG's water business using a group average water multiple of 28x. The valuation reflects strong regulatory exposure and public M&A opportunities, balanced by growth visibility lower than peers and near-term risk from closing recent public M&A deals. We value the regulated gas business at a 5% premium to the average 2023 multiple of 17x for our electric and gas group coverage, reflecting a strong growth profile and familiar regulatory exposure.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: Risks to WTRG include rate case outcomes and general regulatory treatment, gas price inflation impacts on customer bills, and general interest rate environments.

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